



# Montana State Fund

Legislative Finance Committee  
Workers' Compensation  
Sub-Committee  
October 8, 2008



# Montana State Fund

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- **A Short Summary of Montana State Fund (MSF)**
  - **Established**
    - 1915 (Originally)
    - 1990 (In Present Form with Separation of Unfunded Liability or Old Fund)
    - Guaranteed Insurer for Workers Compensation Insurance in a Competitive Market Environment
  - **Governance**
    - Seven Member Board of Directors (Appointed by the Governor)
    - Two Legislative Liaisons
  - **Scope of Operations (FY 2008)**
    - Premium Revenue - \$231.0M
    - Policies Issued – 30,305
    - Average Policies in Force (at June 30, 2008) – 28,234
    - New Claims Reported – 14,439
    - Open Claims – 8,651
    - Loss & LAE Reserves - \$752.2M
    - Equity - \$217M
    - Employees – 298 FTE



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- Section 39-71-2363 (2) (b), MCA - Submission of Budget – Annual Report
  - Upon approval of the estimated budget for the succeeding fiscal year, the state fund shall, no later than October 1 of each year, submit the approved annual budget for review to the Legislative Finance Committee established under 5-12-201.



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- **Legislative Finance Sub-committee on Workers Compensation Request**
  - MSF to Provide a Summary of Procedures and Reports Provided to MSF Board of Directors to Provide Assurances of Full Accrual Considerations in Budgeting and Financial Projections.
- **Please Note:** this entire report will not be presented in detail to the committee. It is provided for the committee's review and consideration. A summarized version will be presented on October 8, 2008.



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- **Montana State Fund Board of Directors Reviews and Approves Each of the Following Critical Reports.**
  - Strategic Business Plan (including the Financial Key Success Measures and Financial Projections included in the Plan)
  - The Fiscal Year Budget
  - The Fiscal Year Financial Statements



# Montana State Fund

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- Financial Management Basis
  - Cash Basis Defined
    - All Transactions Recorded When the Cash Changes Hands (Short Term/Immediate)
      - **PROS** – Good Job of Tracking Cash
      - **CONS** – Poor Job of Matching Revenues Earned with Amounts Paid Out for Expenses
      - Application by MSF
        - » Premium Projections
        - » Expense Budgeting



# Montana State Fund

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- Financial Management Basis
  - Accrual Basis Defined
    - All Transactions Recorded When They Occur and in the Period Incurred (Long Term/Complete)
      - **PROS** – Good Job of Matching Revenues and Expenses
      - **CONS** – Poor Job of Tracking Cash
      - Application by MSF
        - » Rate Setting
        - » Ultimate Loss Selections
        - » Investment Income
        - » Premium Projections
        - » Financial Statements



# Montana State Fund

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- **MSF Financial Control Evaluation and Decision Points**
  - A. Rate Level
  - B. Premium Projections
  - C. Losses
  - D. Expenses
  - E. Investment Income
- **All Used to Create Financial Statements**





# Montana State Fund

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- **Common Elements in Preparing Each Decision Point**
  - 1) **Basis – Accrual or Cash**
  - 2) **Process – Derivation of Component**
  - 3) **Prepare – Responsibility**
  - 4) **Review – Examination or Study**
  - 5) **Approve – Accept as Appropriate**
  - 6) **Monitor/Evaluate – Comparison to Expected Results, Evaluate Significance of Variance and Adjust or Take Action as Needed**



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## A. Rate Level

1) Basis – Full Accrual

2) Process

- Independent Consulting Actuary Evaluates Adequacy of Current Rate Level in Covering Expected Ultimate Loss and Expense with Margin for Equity Contribution
- Expected Results for Prospective Year Based on Experience of Prior Periods



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## A. Rate Level (cont.)

### 3) Prepare

- MSF
  - Actuarial Team
  - Independent Consulting Actuary
  - Finance Team

### 4) Review

- MSF Senior Management
- Board of Directors/Legislative Liaisons
- Non-MSF – Independent Consulting Actuary



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## A. Rate Level (cont.)

### 5) Approve

- MSF Senior Management Makes Recommendation to Board
- Board of Directors Determines and Approves Rate Actions
- Non-MSF – Independent Consulting Actuary Provides Opinion on Rate Adequacy

### 6) Monitor/Evaluate

- MSF Actuarial Team Analyzes Actual vs. Estimate on Quarterly Basis
- Non-MSF – Consulting Actuary Conducts Semi-Annual Review
- Legislative Audit Division (Independent Consulting Actuary)



# Montana State Fund

<u>Effective Date</u>	<u>MSF Rate</u>	<u>NCCI Loss Cost</u>
7-1-1996	(15.4%)	(14.6%)
7-1-1997	(5.6%)	(8.4%)
7-1-1998	(3.0%)	(12.8%)
7-1-1999	(2.0%)	(7.4%)
7-1-2000	0.0%	(2.4%)
7-1-2001	2.7%	(1.5%)
7-1-2002	2.8%	(0.4%)
7-1-2003	11.6%	13.2%
7-1-2004	9.5%	7.5%
7-1-2005	3.0%	12.1%
7-1-2006	2.4%	2.4%
7-1-2007	(1.0%)	(1.3%)
7-1-2008	(3.0%)	(1.8%)

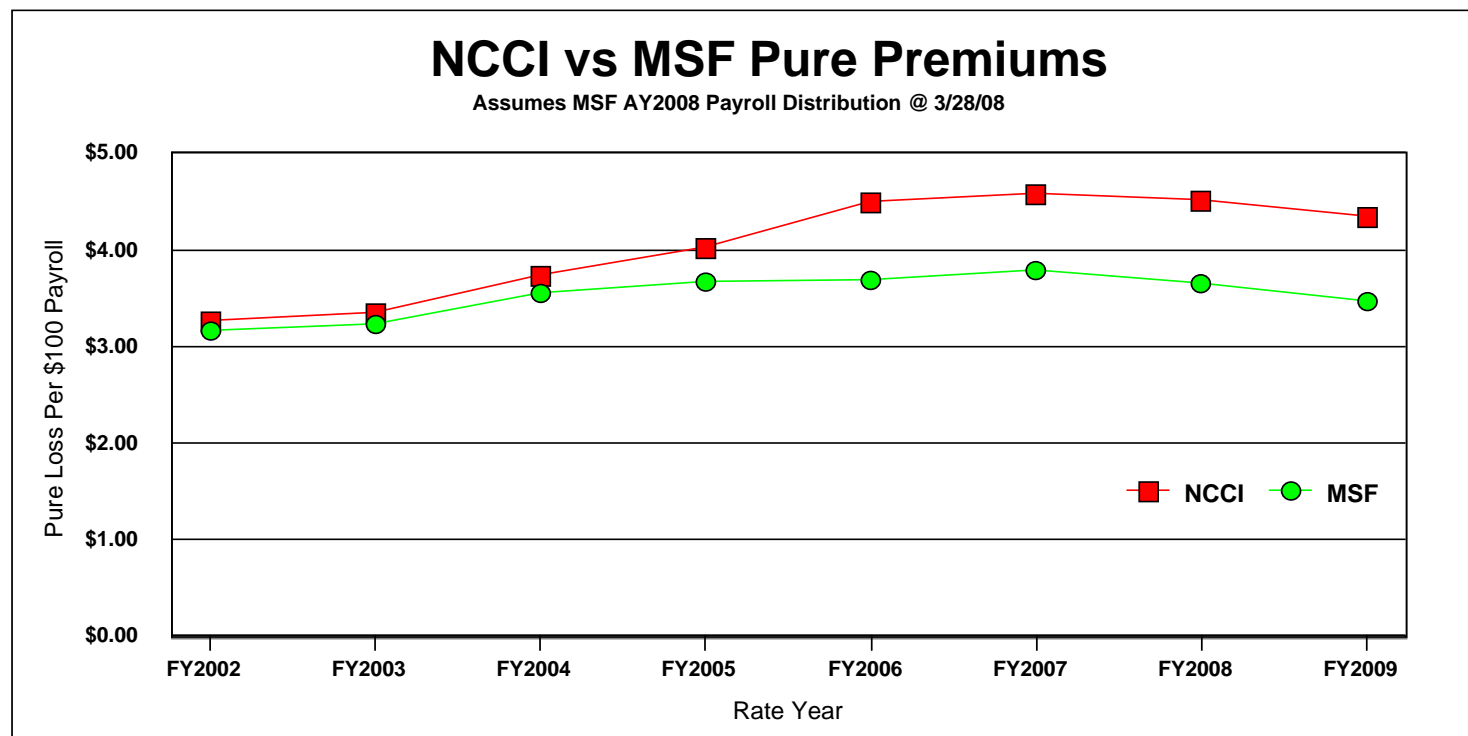
MSF has experienced stability in rate fluctuations over the last 4 Years while achieving strong financial results.

Most recently resulting in an average 3% reduction for rates effective July 1, 2008 and equity growth of 70% since FY 2004.



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MSF Rate Remains Below NCCI by 20%



NCCI versus MSF Pure Premium

	2002	2003	2004	2005	2006	2007	2008	2009
NCCI	\$3.27	\$3.35	\$3.74	\$4.03	\$4.51	\$4.59	\$4.51	\$4.35
MSF	\$3.17	\$3.23	\$3.56	\$3.67	\$3.69	\$3.79	\$3.67	\$3.47
MSF % Difference from NCCI	-3.1%	-3.7%	-5.0%	-8.9%	-18.2%	-17.5%	-18.8%	-20.1%



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## B. Premium Projections

1) Basis – Accrual and Cash

2) Process

- Analysis of Current and Projected Trends Relative to Market Conditions, Competitive Environment, Economy, Wage Levels, and Policy Audit Experience in Light of Anticipated Rate Level



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## B. Premium Projections (cont.)

### 3) Prepare

- MSF
  - Operations (Team Leaders, Underwriters, Marketing)
  - Actuarial Team
  - Finance Team

### 4) Review

- MSF
  - Strategic Business Planning
  - Senior Management
- Board of Directors/Legislative Liaisons





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## B. Premium Projections (cont.)

### 5) Approve

- MSF Senior Management
- Board of Directors (As Part of FY Strategic Business Plan)

### 6) Monitor/Evaluate

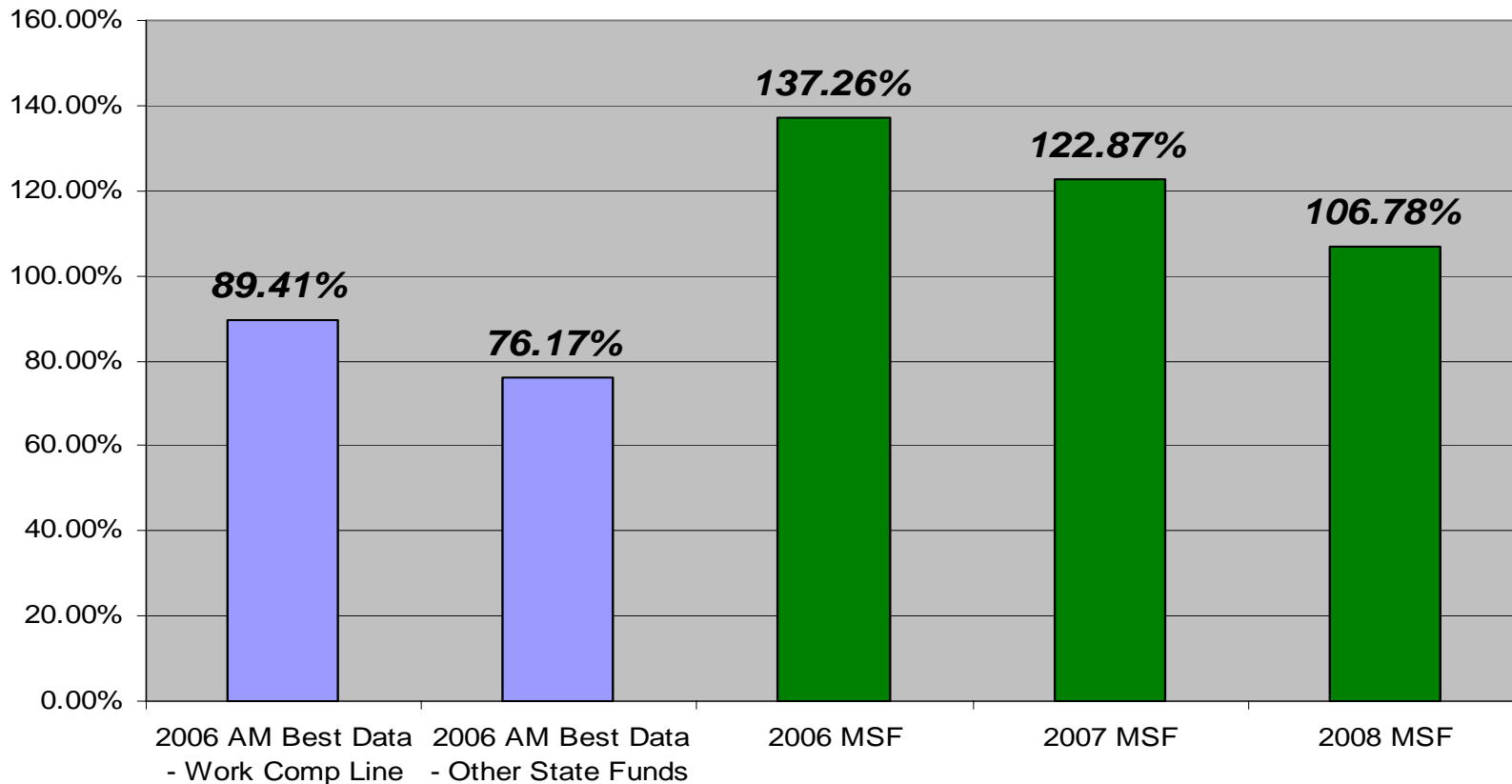
- Monthly Review by MSF Senior Management
- Quarterly Reconciliation of Actual vs. Planned Performance as Part of Financial Reports and Budget Variance Report
- Quarterly Review at MSF Board of Directors Meetings with Financial Reports and Comparison to Business Plan



# Montana State Fund Comparison

Premium to Surplus Ratio – Measures sensitivity of equity to variations in pricing. MSF (as a non-profit entity) has shown significant improvement.

**Net Premiums Written to Surplus Ratio**





# Montana State Fund

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## C. Losses

### 1) Basis – Full Accrual

### 2) Process

- Independent Consulting Actuary Estimates Losses for all Claims with Dates of Injury Within Each Respective Accident Year
- Losses and Changes (+/-) in Prior Accident Periods are Recognized in the Fiscal Year in Which the Change is Identified
- Total Amount of Unpaid Ultimate Losses are Recorded on MSF Balance Sheet as a Liability



# Montana State Fund

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## C. Losses (cont.)

### 3) Prepare

- MSF
  - Actuarial Team
  - Finance Team
  - Operations
  - Operations Support
- Non-MSF - Independent Consulting Actuary

### 4) Review

- MSF – Senior Management
- Board of Directors/Legislative Liaisons
- Non-MSF
  - Independent Consulting Actuary
  - LAD (Independent Consulting Actuary)
  - External Audit Firms



# Montana State Fund

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## C. Losses (cont.)

### 5) Approve

- MSF Senior Management Makes Recommendation to Board Annually
- Board of Directors Determines and Approves Loss and LAE Reserves to be Recorded on MSF Financial Statements
- Non-MSF – Independent Consulting Actuary Provides Opinion on Loss Reserve Adequacy

### 6) Monitor/Evaluate

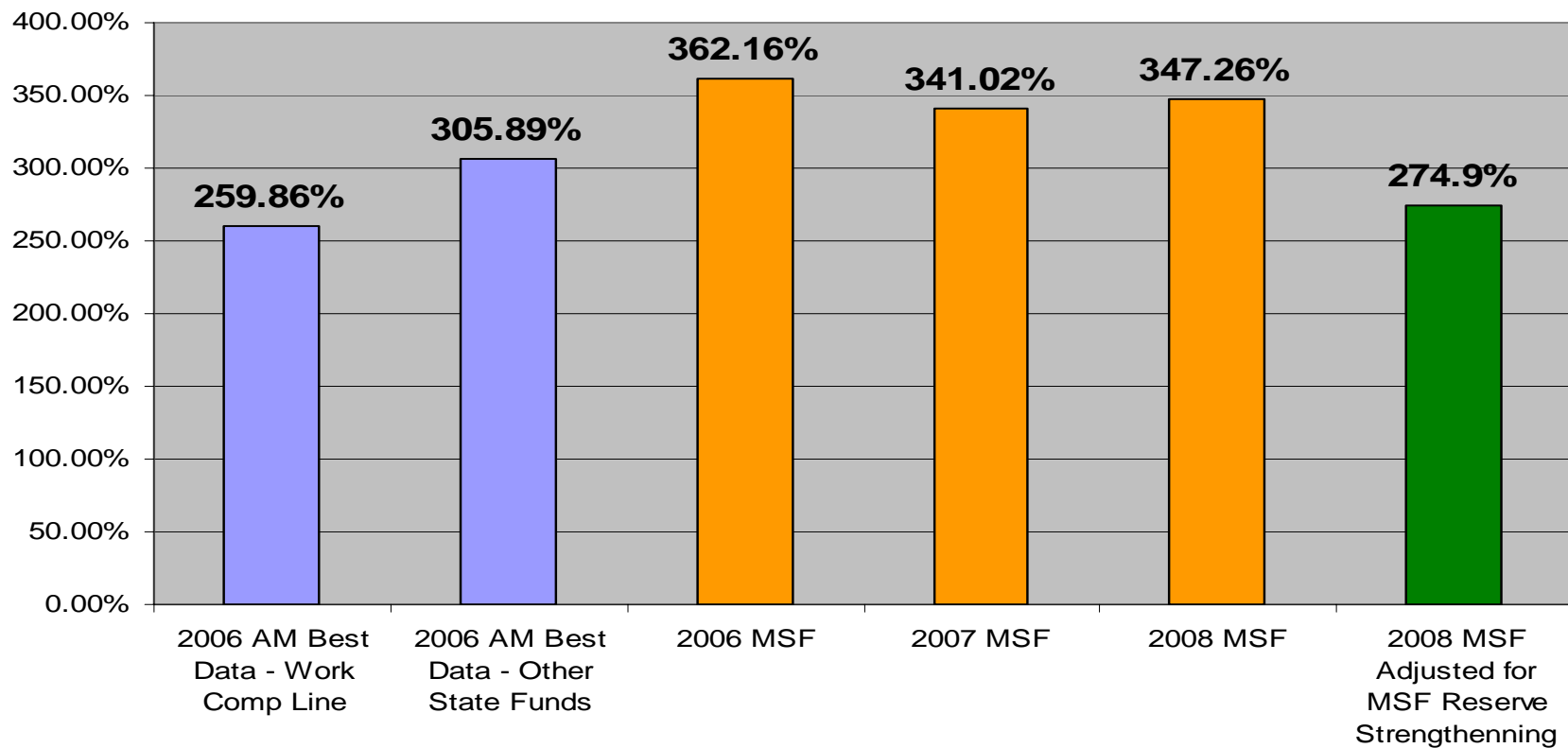
- MSF Actuarial Team Analyzes Actual vs. Estimate on Quarterly Basis
- Non-MSF – Independent Consulting Actuary Conducts Semi-Annual Review
- Results Communicated to MSF Senior Management and Board of Directors Quarterly in Financial Reports
- LAD Consulting Actuary concludes on Reasonableness



# Montana State Fund Comparison

Reserves to Surplus Ratio – Measures Ability to Absorb Loss Development Impact on Equity. MSF has \$41.8M in Loss Reserves Above the Actuarial Estimate as an additional hedge against development.

**Loss and LAE Reserves to Surplus Ratio**





# Montana State Fund

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## D. Expense Budget

### 1) Basis – Cash

### 2) Process

- Budget is Developed on a Cash Basis to Plan and Adopt Expenditures and Measure Cash Flow for the Fiscal Year
- All Departments Submit Expense Detail by Budget Category to Finance
- Finance Aggregates Functional Detail to Arrive at Enterprise-Wide Budget



# Montana State Fund

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## D. Expense Budget (cont.)

### 3) Prepare

- MSF – All Departments

### 4) Review

- MSF
  - Finance Team
  - Internal Audit
  - Strategic Business Planning
  - Senior Management
- Board of Directors/Legislative Liaisons





# Montana State Fund

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## D. Expense Budget (cont.)

### 5) Approve

- MSF Senior Management Makes Recommendation to Board to Adopt FY Expense Budget
- Board of Directors Approves Annual Budget

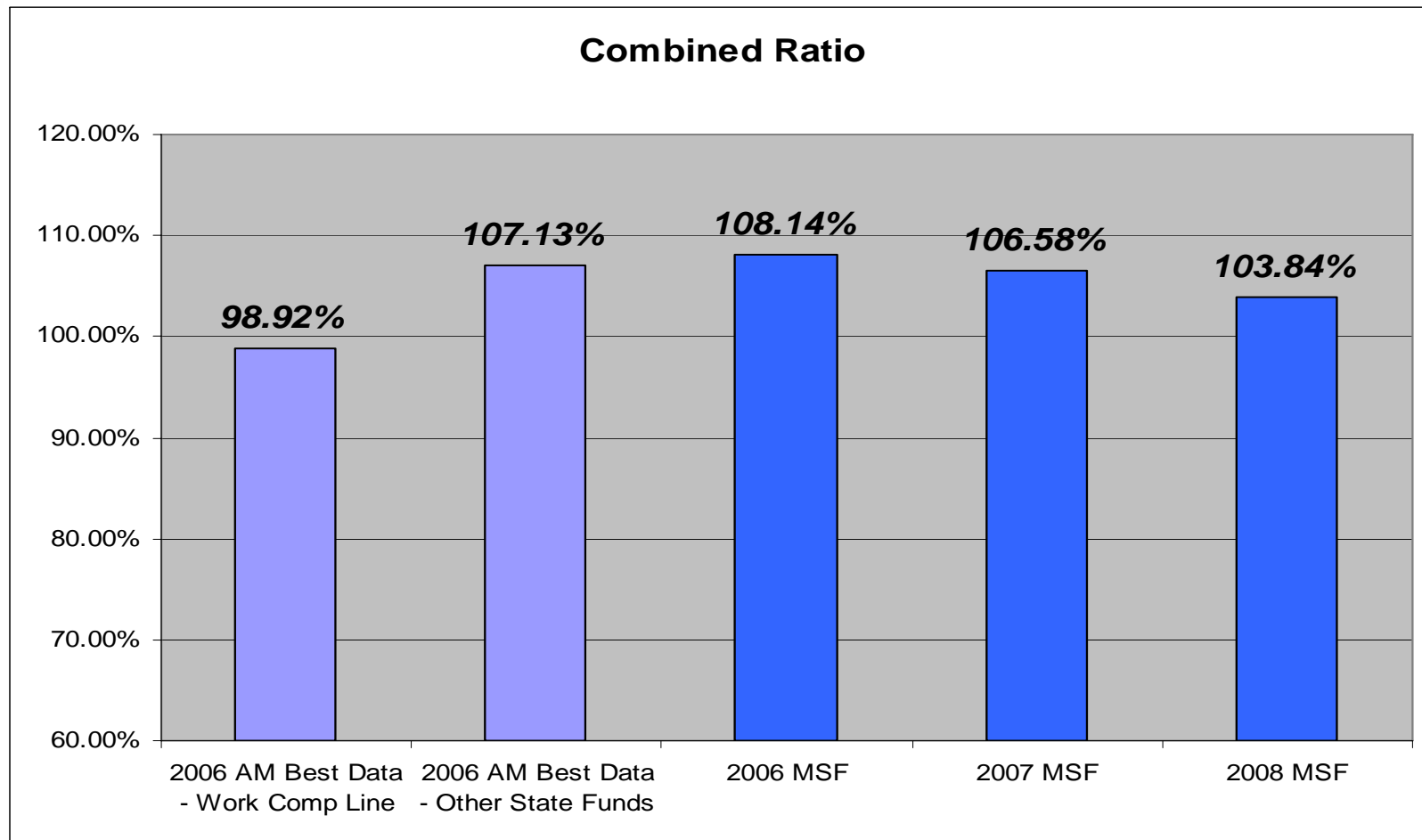
### 6) Monitor/Evaluate

- Monthly Review by MSF Senior Management
- Quarterly Reconciliation of Actual vs. Planned Performance as Part of Financial Reports and Budget Variance Report
- Quarterly Reporting to MSF Board of Directors



# Montana State Fund Comparison

Combined Ratio (Including Dividend) – Losses plus expenses as a function of premium.

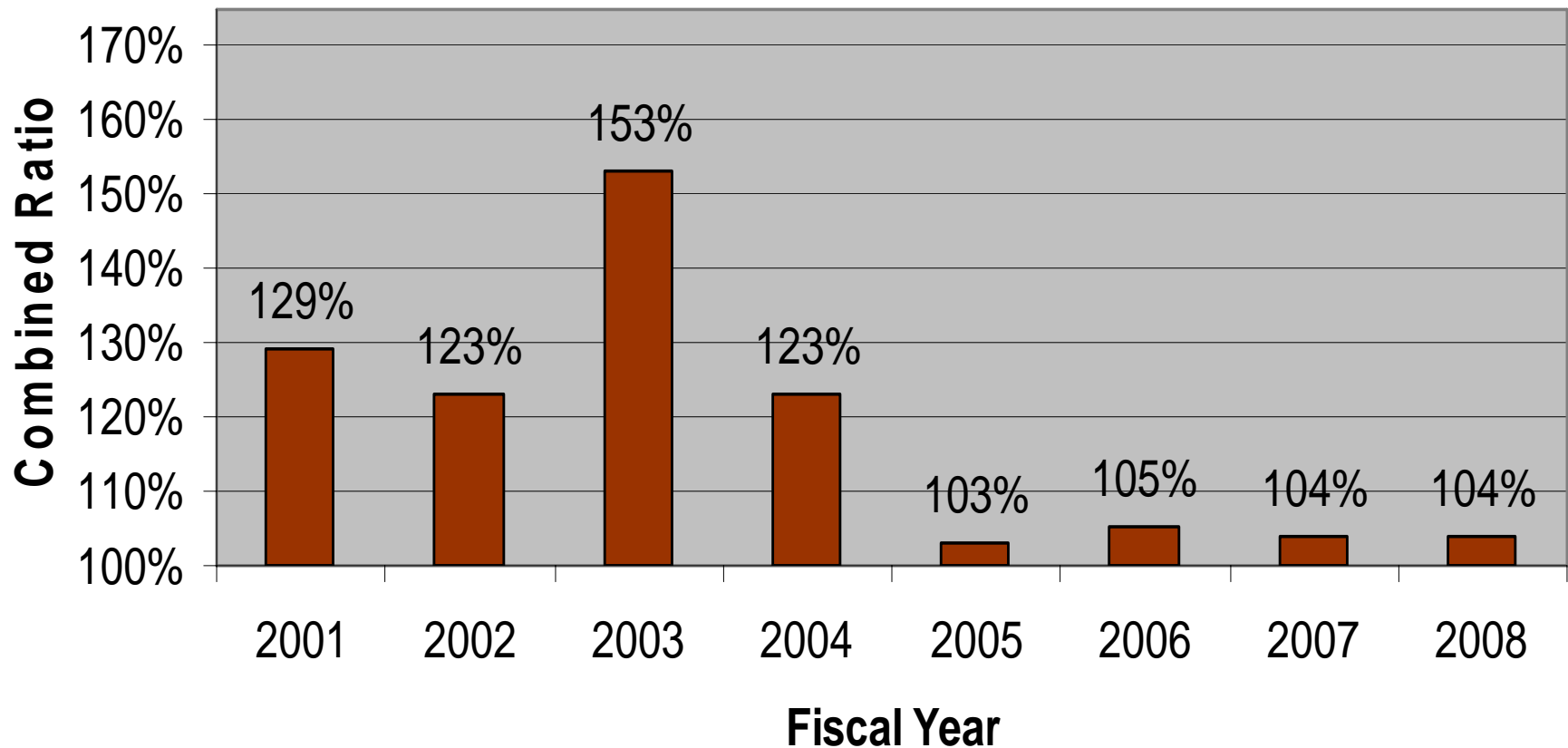




## MSF Combined Ratio History (Excluding Dividend)

MSF Combined Ratio in past 4 years demonstrates a stable market participant for Montana. (Combined with 4 years of stable rates)

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# Montana State Fund

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## E. Investment Income

1) Basis – Full Accrual

2) Process

- Investment Portfolio Managed by Board of Investments
- Accounting for Investments and Other Income Maintained by MSF Finance Team



# Montana State Fund

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## E. Investment Income (cont.)

### 3) Prepare

- MSF – Finance Team
- Non-MSF – Board of Investments

### 4) Review

- MSF – Senior Management
- Board of Directors/Legislative Liaisons



# Montana State Fund

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## E. Investment Income (cont.)

### 5) Approve

- Board of Investments Board of Directors Establishes and Approves Investment Policy Statement for MSF and Old Fund Assets
- MSF Board of Directors Approves as Part of Financial Projections Included in Strategic Business Plan

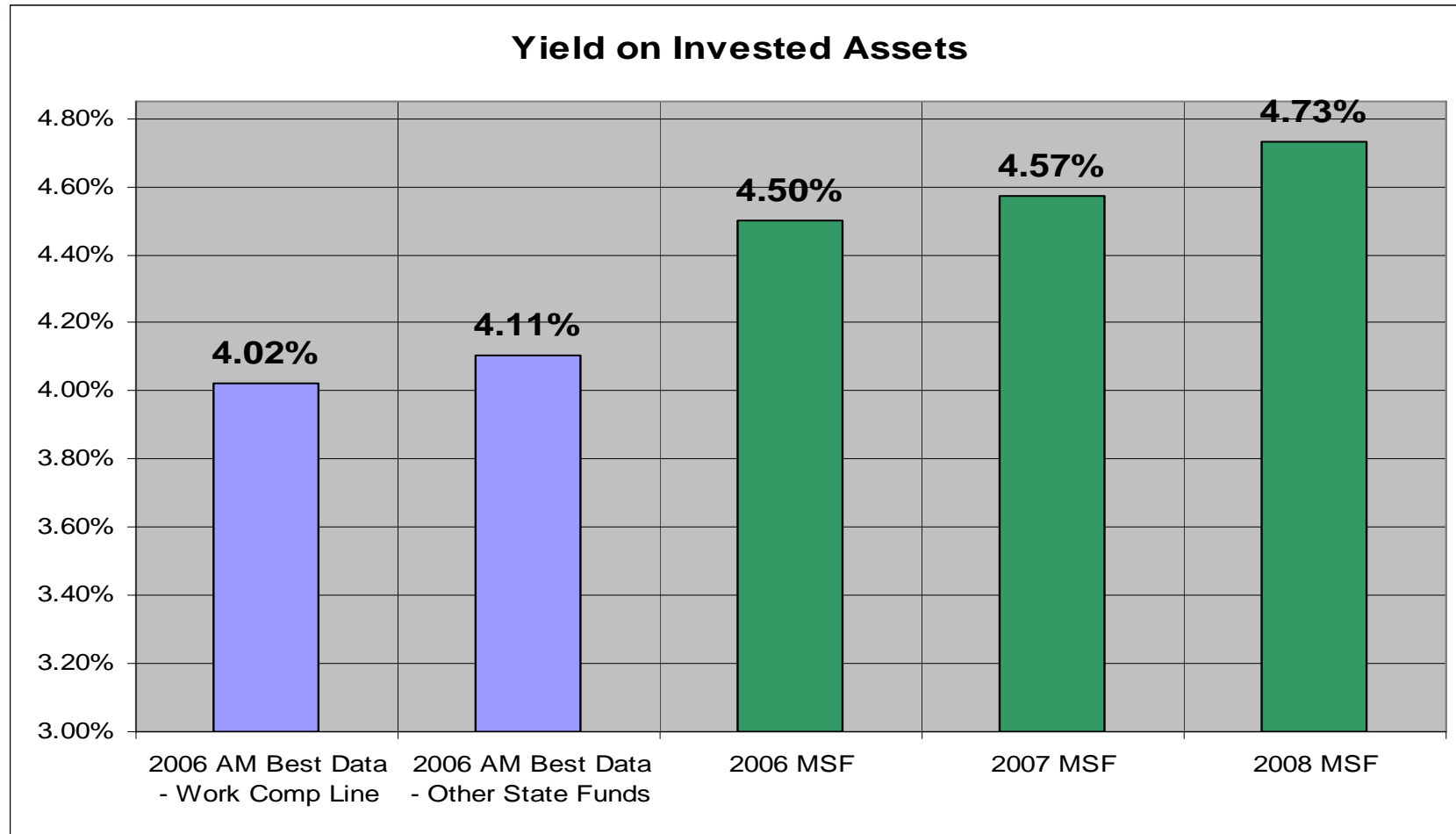
### 6) Monitor/Evaluate

- Monthly Review by MSF Senior Management as Part of Business Review Process
- Quarterly Reconciliation of Actual vs. Planned Performance as Part of Financial Reports and Budget Variance Report
- Quarterly Review at MSF Board of Directors Meetings as Part of Financial Reports



# Montana State Fund Comparison

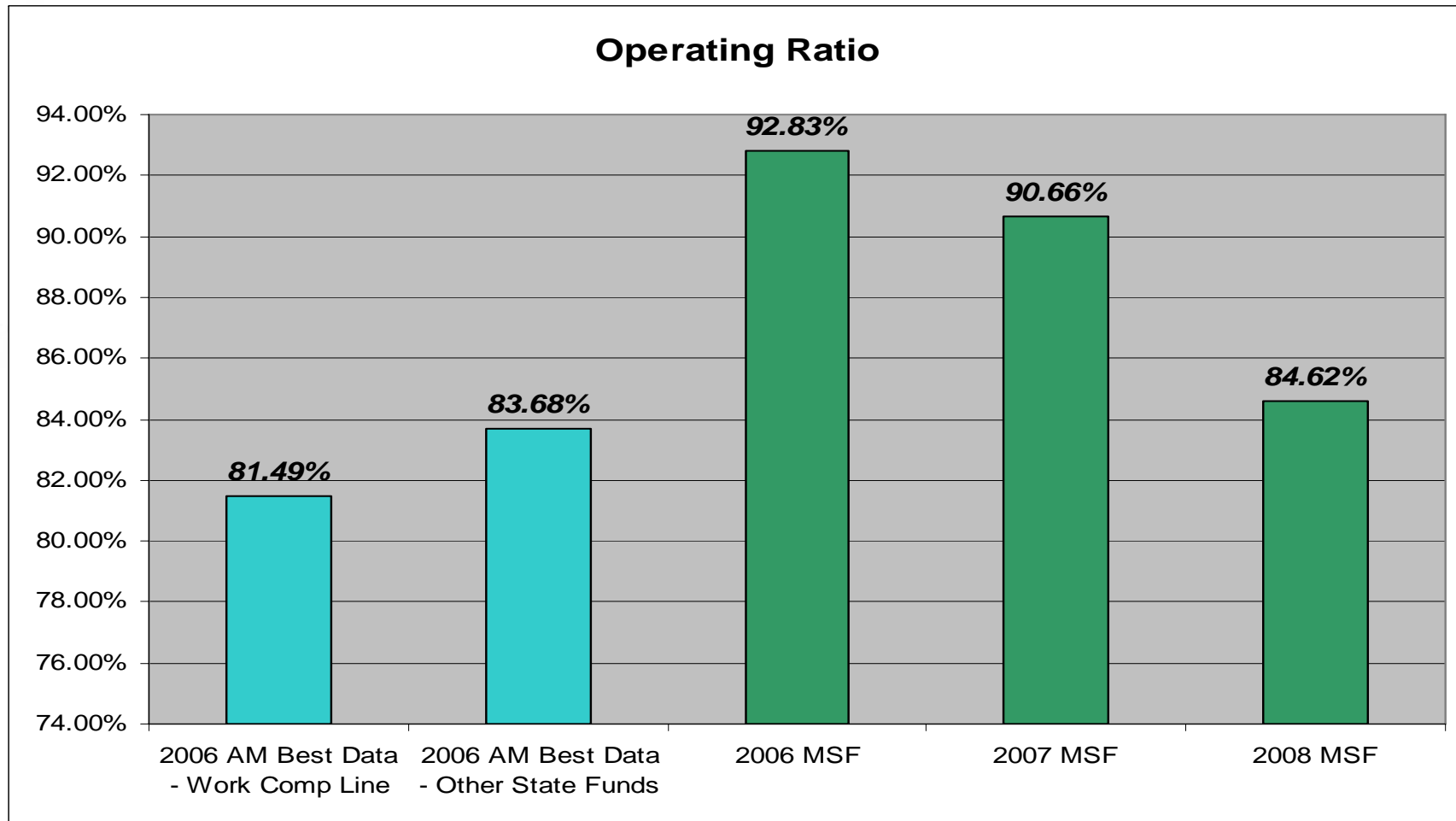
Long Term stability of the yield on invested assets is an indicator of the overall quality of the assets.





# Montana State Fund Comparison

Operating Ratio (Combined Ratio less Investment Income Ratio) –  
Measures Management's Efficiency to generate contribution to equity.







# Montana State Fund

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## **F. Financial Statements (In Accordance with Insurance Industry Practice)**

**1) Basis – Full Accrual**

**2) Process**

- **Repository for Data from All Financial Components**
  - **(Premium, Losses, Expenses, and Investments) and Source System Financial Transactions for the Accounting Period**



# Montana State Fund

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## F. Financial Statements (In Accordance with Insurance Industry Practice) (cont.)

### 3) Prepare

- MSF – Finance Team

### 4) Review

- MSF
  - Finance Team
  - Actuarial Team
  - Senior Management
- Board of Directors/Legislative Liaisons
- Non-MSF
  - Independent Consulting Actuary
  - LAD (Independent Consulting Actuary) Issues GASB (Government Accounting Standards Board) Opinion
  - External Audit Firm Issues NAIC (National Association of Insurance Commissioners) Opinion



# Montana State Fund

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## **F. Financial Statements (In Accordance with Insurance Industry Practice) (cont.)**

### **5) Approve**

- MSF Senior Management
- Board of Directors

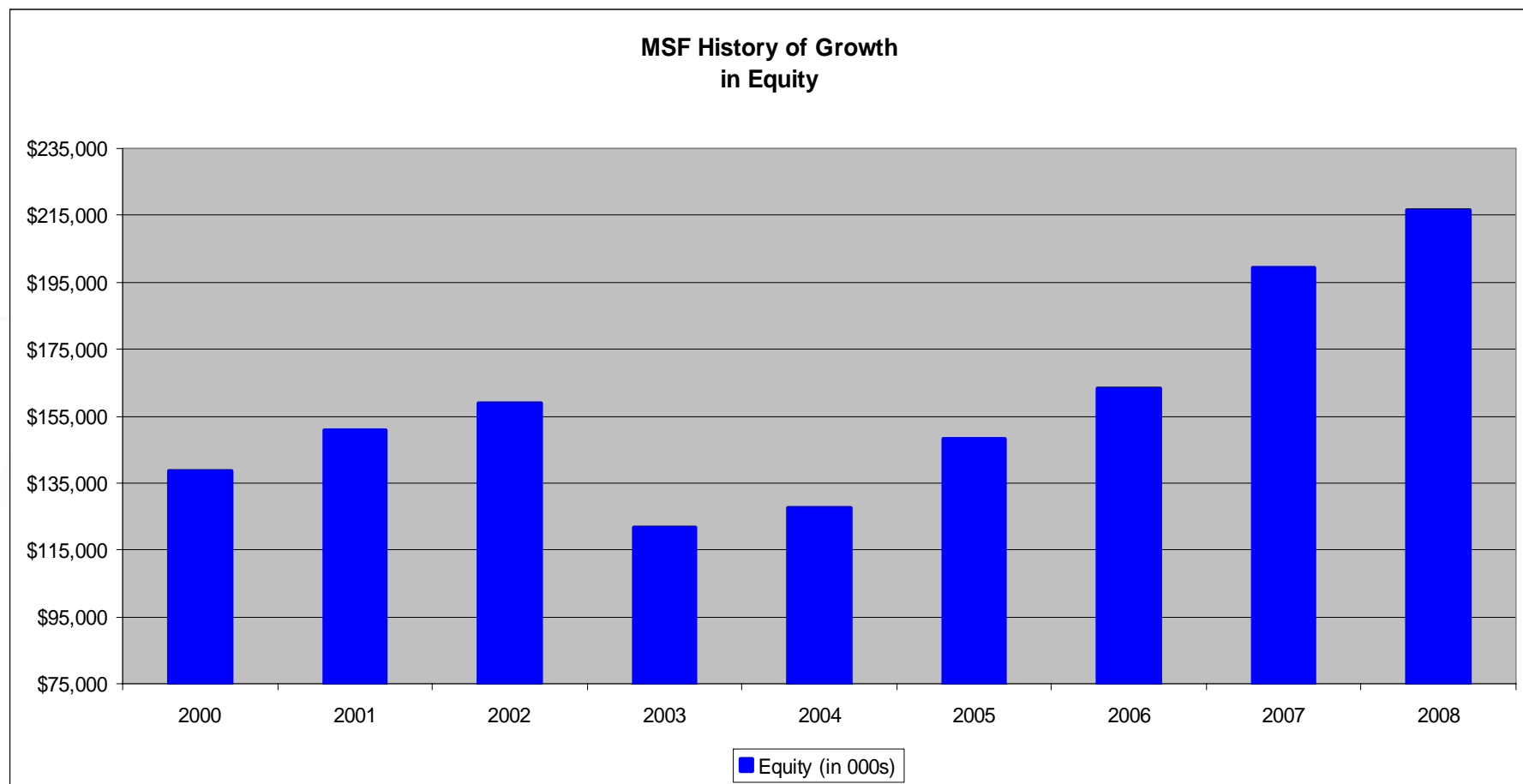
### **6) Monitor/Evaluate**

- Quarterly Reconciliation of Actual vs. Planned Performance as Part of Financial Reports and Budget Variance Report
- Quarterly Review at MSF Board of Directors Meetings



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MSF continues to strengthen equity





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## Accrual Basis Vs. Cash Basis Components

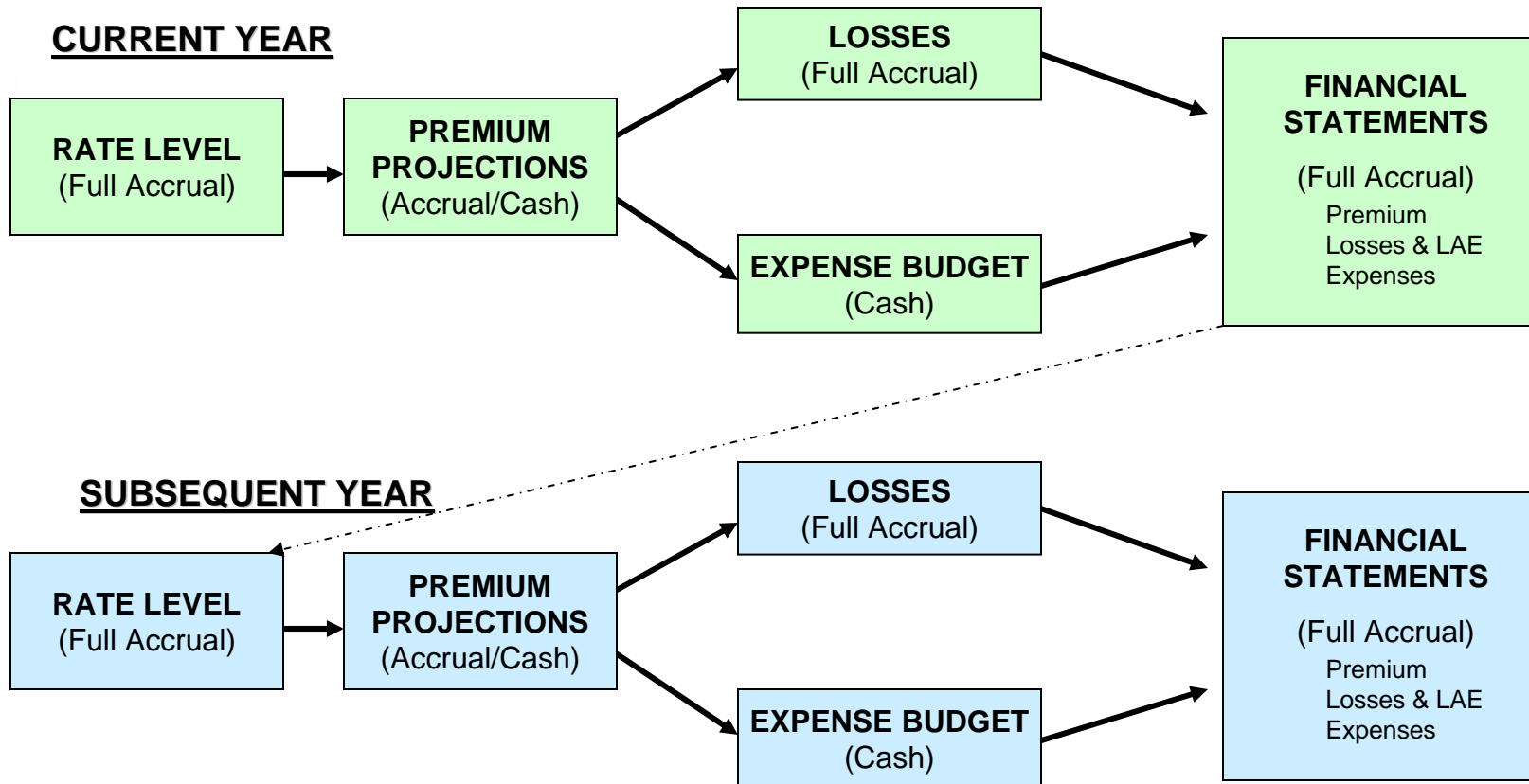
(Both Are Used by Management)

<u>Basis</u>	<u>Estimate Process</u>	<u>Actual Measurement</u>
<i>Cash</i>	Budget	Fiscal Year Expenditures
<i>Accrual</i>	Strategic Business Plan	Financial Statements



# Financial Management Cycle

(Process Resulting in Financial Projections for Strategic Planning)





# Montana State Fund

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- **Future Risk Challenges**
  - Court Cases
  - Medical Cost Inflation
  - Aging/Shrinking Workforce
  - Financial Markets
  - Economy
- **Old Fund**